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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-438

MOBIL OIL CORPORATION,
Petitioner,

v.

FEDERAL POWER COMMISSION,

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Note: Federal Power Commission Opinion Nos. 607 and 607-A and its Order Denying Rehearing are reproduced at pages 298, 547, and 564, respectively, of Part I of the Joint Appendix, as prepared for the lower court. Copies of Part I have been filed with the Clerk of the Supreme Court in conjunction with these Appendices to the Petition for Writ of Certiorari.

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MOBIL OIL CORPORATION, *Petitioner*,

v.

FEDERAL POWER COMMISSION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Mobil Oil Corporation (Mobil) petitions for a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this case on June 8, 1973.

OPINIONS BELOW

The opinion of the Court of Appeals (Appendix B, pp. 3-29) is not yet reported. The opinions and orders of the Federal Power Commission are reported at 46 FPC 900, 47 FPC 99, and 47 FPC 743.[1]

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[1] Appendices to this Petition include the judgment and opinion of the Court of Appeals. With those Appendices, petitioner has filed forty copies of the volume of the printed Joint Appendix in the Court of Appeals containing the opinions and orders of the Federal Power Commission. References to that volume are by the pagination used below, *e.g.*, R. 12,083, R. 12,331. In addition, references are made in this Petition to the opinion of the United States Court of Appeals for the District of Columbia Circuit of August 24, 1973, in *Texas Gulf Coast Area Natural Gas Rate*

JURISDICTION

The judgment of the Court of Appeals was entered on June 8, 1973 (Appendix A, p. 1), and this petition is filed within ninety days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r (b).

QUESTIONS PRESENTED

In "area rate" proceedings under Sections 4 and 5 of the Natural Gas Act to fix maximum rates for producers' sales of natural gas in Arkansas, Mississippi and parts of Alabama, Oklahoma, Texas, and Louisiana, the Federal Power Commission imposed a rate structure providing (1) a formula for "forgiveness" or refunds of approximately $5,000,000 owed by area producers, (2) separate maximum area rate ceilings for "flowing" and "new" gas, (3) "moratoria" on rate increases to July 1, 1976 and (4) no allowances to cover producers' payment of royalty on bases exceeding the prescribed area rates. Even though it found parts of the Commission opinion deficient as to findings, conclusions, and evidentiary support for the rate ceilings, the Court of Appeals for the Fifth Circuit affirmed, but held that the Commission nevertheless would have "authority" to "alter or modify" the "flowing" gas rates, refund liabilities, and moratoria either prospectively or retroactively. Questions presented are:

1. Whether standards of Sections 4 and 5 of the Natural Gas Act prohibiting unduly discriminatory, un-

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Cases, —— F. 2d —— (No. 71-1828, D.C. Cir.). Forty copies of that opinion have been filed as a Supplement to the Appendix to Mobil's Petition for Writ of Certiorari filed this day as to the Fifth Circuit's opinion and judgment in *Placid Oil Company* v. *Federal Power Commission*, —— F. 2d —— (No. 71-2761, decided April 16, 1973).

duly preferential, anti-competitive, and unreasonable rates are violated by a "refund credit" formula which favors a few producers who collected the highest rates in the past and provides additional working capital for such producers, but imposes maximum area rates on all other producers without comparable capital allowances.

2. Whether maximum area rates are "just and reasonable" under the standards of Sections 4 and 5 of the Natural Gas Act, as construed in *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591 (1944), and *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), where such rates do not include allowances for current exploration and development expenditures and a rate of return comparable to the allowances provided by rates fixed for other regulated sales under similar circumstances, conditions, and risks.

3. Whether "moratoria" on access to rate changes under Section 4 of the Natural Gas Act, extending to July 1, 1976, are unjust, unreasonable, and unsupported by required findings of fact and substantial evidence under criteria for valid "moratoria" set out in *Permian* as to projections of future stability of costs and revenue requirements.

4. Whether in computing and determining costs, revenue requirements, and area rates, the Commission unlawfully failed to allow for, or provide adjustment for, payment by producers of royalty computed on bases exceeding the producers' filed and effective rates under final orders issued under the Natural Gas Act.

5. Whether under Section 19(b) of the Natural Gas Act, a Court of Appeals may affirm and "enforce" orders of the Federal Power Commission after finding such orders deficient as to findings of fact and supporting substantial evidence on the assumption that even after such affirmance, the Commission may modify such orders retrospectively and prospectively.

STATUTES INVOLVED

Sections 4, 5 and 19(b) of the Natural Gas Act, 52 Stat. 821, 822, 831 (1938), 15 U.S.C. §§ 717c, 717d, 717r, are involved and are reproduced at Appendix C, pp. 33-35.

STATEMENT

This case has become, in effect, a companion case to *Placid Oil Company, et al. (SoLa II)* v. *Federal Power Commission*, —— F. 2d —— (Nos. 71-2761, 5th Cir., decided April 16, 1973, reh. den. June 11, 1973), as to which Mobil Oil Corporation (Mobil) has filed a petition for writ of certiorari. While the factual context differs, similar questions are presented as to an unduly discriminatory, unduly preferential, and anti-competitive rate structure; inadequate rate levels and incomplete findings as to rate of return; validity of moratoria; and inadequate provisions to cover royalty payments. This case presents the additional question of lawfulness of "affirmance" of Commission orders under Section 19(b) of the Natural Gas Act after a court of appeals finds such orders deficient under controlling criteria for reversal on judicial review under this statute.

1. *Proceedings Before the Commission.* This case arose under Sections 4 and 5 of the Natural Gas Act, 52 Stat. 822, 823, 15 U.S.C. §§ 717c and 717d. After a formal, adjudicatory hearing, the Commission issued its Opinion Nos. 607 and 607-A prescribing an area rate structure applicable to all independent producers, including Mobil, who sell natural gas subject to the jurisdiction of the Commission in what is denoted the "Other Southwest Area," consisting of parts of the States of Alabama, Mississippi, Louisiana, Arkansas, Texas, and Oklahoma (see R. 12,126).

The proceeding was initiated on February 28, 1967, as something of a "catch-all" for producing fields in the

Southwest which had not been included in earlier area rate proceedings, but which then provided approximately 14% of natural gas sold in interstate commerce for resale (R. 10,911-10,915). The hearing was conducted before a Hearing Examiner, who issued his decision on September 22, 1969. Exceptions and oral arguments before the Commission followed, and Commission Opinion No. 607 was issued October 29, 1971 (R. 12,083-12,208). Applications for rehearing were filed, and Opinion No. 607-A was issued on January 17, 1972, modifying Opinion No. 607, particularly as to treatment of refunds (R. 12,331-12,339). Mobil filed for rehearing upon these changes, but that application for rehearing was denied on March 8, 1972 (R. 12,351-12,353). Mobil filed timely petition for review in the Court of Appeals for the District of Columbia Circuit, and that petition was transferred to the Fifth Circuit.

Major provisions of the Commission opinions pertinent to issues now raised by Mobil are:

A. *Determination of Area Rates.* For nine "subareas," the Commission established a complex structure of maximum rates, dividing sales among (1) producers' sales contracts dated prior to January 1, 1961; (2) contracts dated between January 1, 1961 and October 1, 1968; and (3) contracts dated on or after October 1, 1968 (see Table at R. 12,097). Within these groups, various rates were set for three different time periods prior to September 30, 1973. All such rates are to escalate 1 cent per Mcf on October 1, 1973; deductions were provided where gas is not gathered to a central point in the field by the producer; the rates are to be adjusted upward and downward from prescribed "maximum and minimum standards" for BTU content (R. 12,130); and other "quality standards" are prescribed (R. 12,130-12,131).

Exact derivation of the rates was not clear. The Commission first noted that this is not a "homogeneous area" (R. 12,092), and divided its discussion as to the various sub-areas. First, however, the Commission cited generally-applicable circumstances as to supply and marketing, incorporated its findings in other cases as to existence of a natural gas shortage, and found that in this area ". . . the gas supply situation is worse than in the nation as a whole" (R. 12,098); and further found:

> "While we cannot expect that this area will be able to supply the potential demand upon it, it is important that its potential be fully utilized in this time of national need for all available gas." (R. 12,099-12,100)

To meet demand, the Commission also found that "the level of new discoveries must be even higher" (R. 12,101), and that the rates it fixed "will enable the interstate market to compete in price with the present and potential intrastate buyers in the area," but that "40 to 45 per cent of the gas production goes to the intrastate market" (R. 12,102).

As to objectives of its orders, the Commission said that its "rate design" should "encourage new exploration and development"; and that "attractiveness of the many alternative investment possibilities must be considered in providing inducements to the necessary capital investment to the end that the continuing decline in exploration for and development of gas reserves in this area may be reduced" (R. 12, 104). The Commission further stated that it would consider "not only the various cost computations, but also the levels of interstate prices in each sub-area, the levels of the unregulated intrastate price in each sub-area, the levels of prices in adjacent areas where the Commission has established area rates, the varying pricing history and quality conditions in each such area

as compared with the particular Other Southwest sub-area" (R. 12,104).

Thereupon, the Commission took up rates in "States domains" under contracts dated on or after October 1, 1968, and fixed rates for this "new gas" vintage by reference to other area rate decisions, past "guideline" rates, intrastate prices, and other factors (R. 12,105-12,109). It then set forth rates for seven sub-areas, ranging from 25 cents per Mcf for Mississippi, Alabama and Northern Louisiana to 22.5 cents for Southern Arkansas; and further provided that the rates would escalate one cent on October 1, 1973 (R. 12,109). The rate for the Federal Domain offshore Mississippi was fixed at the 26-cents level previously fixed for Southern Louisiana, with the same escalation on October 1, 1973 (R. 12,110-12,112).

Rates for contracts dated prior to October 1, 1968 were separately discussed by sub-area (R. 12,112-12,121). The Commission compared existing "jurisdictional prices," "intrastate prices," and the "cost-based" prices recommended by the Hearing Examiner (*e.g.*, R. 12,112). The discussion also included references to the maximum rates already fixed by other area rate decisions in other dockets (*e.g.*, R. 12,112, 12,115, 12,118). This discussion ended with conclusions expressing rates for sub-areas, with different levels within each sub-area for gas delivered prior to January 1, 1965; for gas delivered from January 1, 1965 through September 30, 1968; and for gas delivered after September 30, 1968 (see table at R. 12,119). All of these rates are to escalate 1 cent per Mcf on October 1, 1973 (R. 12,121).

No specific findings were made as to the rate of return for flowing gas.

B. *Coverage of Royalty Payments.* In this area, as in others, more than 14% of producers' revenues is ex-

pended in royalty payments, and royalty payments are a "major" cost item (see R. 11,402-11,403). In computing costs and fixing area rates, two issues thus were presented: (1) whether the percentage used should be 14% or a higher percentage; and (2) whether royalty payments would be computed on the basis of the rates collected by the producer, or on the basis of higher "market values." The percentage of 14% was adopted (R. 11,403), but no provisions were made for upward adjustments when and if the producer must pay royalty based on "market values" higher than Commission-prescribed rates.

In determining new gas-well costs in this and other cases, the Examiner and the Commission simply treated royalty as "derivative" and thus made no determination of how much, either as a percentage or a total, of the revenues allowed under the "new gas" rates would be expended in royalty payments (see table at R. 11,404). In determining the other rates for gas sold under contracts dated prior to October 1, 1968, as reflected *supra*, the Commission made no findings from which the exact allowance for royalty can be determined, but clearly included no provisions for adjustment.

By application for rehearing, Mobil raised the issue that because the Commission had allowed for payment to royalty owners on bases no higher than prescribed "area rates" even where the producer may be required to pay on higher bases, an adjustment had to be made to cover any gap where producers must so pay royalty on bases higher than rates allowed to the producers by the Commission (see R. 12,281, 12,283, 12,293).

In denying that application, the Commission made no reference to this issue or to the effect of judicial reversal of its assertion of jurisdiction over royalty interests in *Denman* v. *J. M. Huber Corp.*, 42 FPC 164, 174 (1969); rev'd, *Mobil Oil Corporation* v. *Federal Power Commis-*

sion, 463 F. 2d 256 (D.C. Cir. 1971), *cert. den.*, 406 U.S. 976 (1972).

C. *Moratorium.* The Commission provided for a one cent per Mcf escalation in "area rates" on October 1, 1973 (R. 41,921), but also provided, without discussion:

> "A moratorium on filing price increases above the applicable area rates will be imposed until July 1, 1976." (R. 12, 123)

No findings appear as a predicate for this provision. Mobil, therefore, sought rehearing on the grounds that this moratorium is unsupported and unlawful, particularly under constructions in *Permian, supra.* However, no mention was made of the issues so raised by Mobil in the opinion denying rehearing.

D. *Treatment of Refunds.* In Opinion No. 607, the Commission ordered producers who had collected amounts subject to refund under Section 4(e) of the Act to refund the difference between amounts collected at higher suspended rates and amounts computed on the basis of the lower maximum area rates prescribed in the opinion (R. 12,124). The Commission concluded that the refunds were "of such small amount that a refund credit" system similar to that established in the Southern Louisiana area should not be established in the Other Southwest Area (R. 12,124).

Various producers sought rehearing, and in Opinion No. 607-A, the Commission amended its order to add a complex provision for "discharge" of such individual company refund liabilities (R. 12,333-12,337). In sum, these provisions are that amounts collected by individual producers subject to refund under Section 4(e) of the Act at rates in excess of the "area rates" prescribed for past periods need not be refunded, but such refund liabilities could be discharged prior to January 1, 1976, by a "credit" of 1 cent per Mcf for each additional Mcf of

gas dedicated to area jurisdictional sales (R. 12,335-12,337).

As it had in the Southern Louisiana area rate docket, Mobil opposed such provisions on grounds, *inter alia*, that such treatment of refunds is unduly discriminatory and preferential in favor of producers who collected the highest rates in the past and against producers, such as Mobil, who had made cash refunds and adhered to lower past Commission guideline prices; and that such provisions are anti-competitive and otherwise in violation of the Act. Accordingly, Mobil applied for rehearing upon these provisions of Opinion No. 607-A (R. 12,341-12,344).

By Order issued March 8, 1972, the Commission denied that application (R. 12,351-12,355). In that order, the Commission concluded that such treatment of refunds due under Section 4(e) was lawful.

The petitions for review before the Fifth Circuit followed.

2. *The Court of Appeals Opinion.* Even though the court found the Commission opinions deficient as to findings on critical decisional issues, the court affirmed and "enforced" the orders on the assumption that despite such affirmance under Section 19(b) of the Natural Gas Act, the Commission could modify the rates and other provisions "both prospectively and retroactively" (App. B, pp. 8, 25-26).

The court first noted interrelation of the opinions with prior area rate decisions, including that for the Southern Louisiana Area (App. B, pp. 5-6). The rate structure summarized *supra* was set forth (App. B, pp. 6-8), and by reference to statistical data, the court noted the critical supply deficiencies in the Other Southwest Area (App. B, pp. 8-11). On specific questions of deficiencies in the rates prescribed, arguments of various parties were analyzed:

(1) The court concluded that the Commission was not required to give controlling weight to competitive market data in fixing area rates and had discretion to accord weight to cost data (App. B, pp. 17-19).

(2) The "new gas" rates were found to be at a "permissible point within the 'zone of reasonableness' " (App. B, pp. 20-23), but with reference to possibilities of "special relief" and a future, superseding "national rate" for new gas (App. B, pp. 22-23).

(3) For "flowing gas," the court noted that the rates apparently were based upon a rate of return of 10.5% and 1962 data, even though the Commission had used 12% in its earlier *Permian* decision in 1965 and 15% in later contemporaneous area rate decisions in 1971 and 1972; and on this issue, expressed "much bewilderment" as to why the 10.5% rate was so used in this case (App. B, p. 23); similarly, the court noted that unlike its actions in other cases, the Commission had omitted an additional allowance for exploration and development and characterized this omission as seeming "administratively incongruous" (App. B, pp. 23-24), and referred to other significant differences in cost allocations and the use of a stale 1962 test year (App. B, pp. 24-25); but instead of reversing and remanding because of these errors, referred to "flexible powers of equity" under Section 19(b) of the Act that would permit the Commission "to alter or modify the maximum rates prospectively or retroactively," even though the orders were "affirmed" and "enforced" on review (App. B, pp. 25-26).

(4) The question of omission of provisions for adjustment of area rates to compensate for payment of royalties on "value" bases exceeding Commission-prescribed rates was disposed of by terse reference in a footnote (App. B, p. 5, n.3) to the court's affirmance of the Commission on the same issue in *Placid Oil Company* v. *Federal Power Commission (SoLa II)*, —— F. 2d ——

(No. 71-2761, decided April 16, 1973), as to which Mobil has filed a petition for writ of certiorari.

(5) The treatment of refunds—estimated to be $5,000,000—was recognized to be based on the Commission's earlier Southern Louisiana area rate opinions, and upon the issues of undue discrimination and preference raised by Mobil, the court "enforced" the formula for reasons stated in the court's affirmance in the *Placid Oil Company* case (App. B, pp. 26-27).

(6) The moratoria on rate increases to July 1, 1976 also were affirmed for reasons stated by the court in its affirmance of the Southern Louisiana opinions (App. B, pp. 27-29), but with repetition of the view that despite the affirmance, the court's "flexible approach" would permit the Commission to "modify or rescind the moratorium if the need arises" (App. B, pp. 27-29).

REASONS FOR GRANTING THE WRIT

Like the Southern Louisiana opinions by the Fifth Circuit in *Placid Oil Company, et al.* v. *Federal Power Commission,* —— F.2d —— (No. 71-2761, decided April 16, 1973, reh. den. June 11, 1973), as to which Mobil has this day filed a petition for writ of certiorari, this case presents questions that are now of national applicability in the administration of the Natural Gas Act and which arise because of novel departures from and conflicts with the principles of area rate-making approved by this Court in *Permian* and the Courts of Appeals.

In addition, the holdings below as to validity of the refund credit formula and related rate structure are now in conflict with the opinion of the United States Court of Appeals for the District of Columbia Circuit decided August 24, 1973, in *Texas Gulf Coast Area Natural Gas Rate Cases,* —— F. 2d —— (No. 71-1828, D.C. Cir.), copies of which have been filed as a Supple-

ment to the Appendix to Mobil's Petition for Writ of Certiorari as to the Fifth Circuit's opinion on Southern Louisiana area rates in the *Placid Oil Company* case. This case also presents a major question of the role of the reviewing court under Section 19(b) of the Natural Gas Act where reversal and remand are indicated, but an "affirmance" is entered on assumptions that the agency, nevertheless, thereafter may modify the affirmed orders both retrospectively and prospectively.

1. The Questions of Unreasonable, Unduly Discriminatory and Preferential Rate Structure and Treatment of Refunds Arise Because of Violation of Principles Approved In *Permian* and Conflicts In Constructions of Sections 4 and 5 of the Natural Gas Act by the Courts of Appeals

In Mobil's petition for writ of certiorari filed as to the Fifth Circuit's opinions of April 16, 1973 and June 11, 1973 in *Placid Oil Company, et al. (SoLa II)* v. *Federal Power Commission*, —— F. 2d —— (No. 71-2761), Mobil has set forth reasons this Court should review the questions raised by the Commission's new formula for treatment of refunds in fixing area rates. The reasons there stated are also applicable to this case.

This case reflects the spreading of that formula to all of the Commission's area rate decisions, with the same unduly discriminatory and preferential results penalizing producers who followed past Commission guidelines and policies and favoring those who collected the highest rates in the past in excess of those guidelines and prescribed just and reasonable rates. As Mobil has shown, this approach to area rate-making cannot be reconciled with principles set out in *Permian* and heretofore applied by the Courts of Appeals in *Mesa Petroleum Company* v. *Federal Power Commission*, 441 F. 2d 182 (5th Cir. 1971); *Plaquemines Oil and Gas Company* v.

Federal Power Commission, 450 F. 2d 1334 (D.C. Cir. 1971), and *Hugoton-Anadarko Area Rate Cases: California* v. *Federal Power Commission*, 466 F. 2d 974 (9th Cir. 1972). In addition, on these issues involving treatment of refunds and related area rate structure, there is a clear conflict between the holding below and the opinion of the District of Columbia Circuit in *Texas Gulf Coast Area Natural Gas Rates*, —— F. 2d —— (No. 71-1828, D.C. Cir., decided August 24, 1973). That court has held this rate structure and method for treatment of refunds to be unduly discriminatory and preferential, anti-competitive, and violative of standards of Sections 4 and 5 of the Natural Gas Act.

While the amounts involved in this case are small in comparison to the hundreds of millions of dollars at issue in the Southern Louisiana case, the adverse impact of the unawful rate structure is similar. Major producing fields in all or parts of six states are covered by the opinions on review, and future performance affecting both producer and consumer interests tied to those fields is at stake. Therefore, the issues in this case as to treatment of refunds, and proper relationship of this extra working capital to the area rates fixed for all producers, also warrant review by this Court.

2. The Affirmance of Recognized Inadequate, Deficient Rates and Inadequate Findings As To Rate of Return Conflicts with Requirements of *Permian* and the *Hope* Test

Where, as here, a reviewing court expresses "bewilderment" at gaps in a Commission opinion (App. B, pp. 7-8, 23), the court's duty under Section 19(b) of the Natural Gas Act is to reverse and remand.

In *Permian* and *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591 (1944), this Court laid out controlling criteria as to such critical issues as

rate of return. This Court has been equally explicit in directing remand where gaps on such controlling questions in rate cases are laid bare. *Colorado-Wyoming Gas Company* v. *Federal Power Commission*, 324 U.S. 626 (1945); see also *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156 (1962).

Plainly, the court of appeals could not discover any agency findings and conclusions supporting the specific results reached by the Commission in this case. The gaps appeared in vital steps of fixing the rate of return for flowing gas, allowance of exploration and development expenditures comparable to allowances being made in other areas, and correction of defective cost allocations by use of methods already being used by the Commission in other area rate decisions (App. B, pp. 23-26). Yet, despite these results and the obligations of reviewing courts spelled out in *Permian* and expressed in Section 19(b) of the Act, there is an "affirmance" and an expression as to "power" in the agency to alter the orders despite that affirmance.

Substantively, the results also cannot be reconciled with the tests for valid allowances for rate of return and revenue requirements under *Permian* and *Hope*. A rate of return that has been abandoned in all other decisions cannot be used, at least without findings and conclusions required by *Permian* and *Hope*. In this instance, there simply are plain errors in the prescription of rates, and no questionable possibility of later voluntary Commission correction, after affirmance, can be relied upon by a reviewing court to cover those errors.

The court below also apparently is evolving a novel doctrine that such plain errors can be so ignored. Yet, the controlling constructions by this Court required a reversal and remand. If there are no required findings, an aggrieved party is entitled to a reversal and prompt Commission reconsideration. In addition, for reasons

Mobil has set out in its petition for writ of certiorari in the Southern Louisiana case, the questions raised as to interrelation of the treatment of refunds and present and future area rate levels involve proper application by the reviewing court of *Permian* and *Hope*. See also majority opinion by Chief Judge Bazelon in *Texas Gulf Coast Area Natural Gas Rate Cases*, —— F. 2d —— (No. 71-1828, D.C. Cir., decided August 24, 1973, slip op., pp. 86, 106-111).

Most of the natural gas now being sold in producing fields in the six states covered by the Commission opinions in this case falls under the "flowing gas" category. Lawful rates, therefore, should be prescribed now, and, as a matter of law under Section 19(b) of the Act, cannot be left in the posture set out by the court below. Rate of return is a critical question and cannot be resolved by expressions of "bewilderment" (App. B, p. 23). In addition, all producer and consumer interests are affected by the question of adequacy of *current* allowances for exploration and development. The treatment of these issues by the court below, therefore, should be reviewed here.

3. The Question of Lawful Allowances For Producers' Payments To Royalty Owners Is Novel and Is Applicable To All Regulated Natural Gas Producers' Rates

The Commission's failure to provide for adjustment to compensate producers for increasing royalty payments directly affects all producers' rates fixed by Commission area rate decisions. While there is no conflict between the Fifth and District of Columbia Circuits in affirmance of such Commission action, the novel questions raised are before this Court in Mobil's Petition as to the Fifth Circuit's "controlling" Southern Louisiana opinion, are of national applicability in the administration of the

Natural Gas Act, and warrant the earliest consideration here.

In this area, lessee producers pay to their lessors royalty payments exceeding 14% of producers' revenues from gas sales. In arriving at total costs to fix area rate ceilings, the Examiner referred to these payments in detail. The Commission, however, made inadequate allowances, thus reducing realization actually to be retained by producers and depriving producers of the reality of "just and reasonable" rate levels.

In arriving at "current costs," the Examiner and the Commission treated the amount to be allowed for royalty payments as "derivative," but made no provision for an allowance exceeding simple mechanical application of a percentage to the ceiling rate (R. 11,402-11,403). In the "flowing gas" costs, the Examiner and the Commission used average costs of producers, but nowhere made provision for royalty payments exceeding levels paid during the test year or exceeding the rates actually received by producers.

As in other area rate decisions, the Commission's conclusions in this case were based on the assumptions that the royalty interest, like the producers' working interest, is subject to Commission jurisdiction, and that Commission-prescribed "area rate" ceilings are equally controlling on the royalty owner. However, in *Mobil Oil Corporation* v. *FPC*, 463 F. 2d 256 (D.C. Cir. 1971), *cert. den.* 406 U.S. 976 (1972), the Commission was reversed as to the exercise of jurisdiction over royalty interests. The court there held that royalty owners could maintain collateral suits to recover payments based on alleged "current market values," and Commission-prescribed rates need not operate as a ceiling. Therefore, none of the assumptions as to Commission-controlled ceilings on royalty payments are correct. Royalty payments will exceed the levels used in arriving at costs to fix

rates, and realization to producers will be reduced to the extent that royalty payments exceed those assumed by the Commission and are based on "current market value" as determined from time to time for the periods covered by the Commission's area rate orders.

Provisions for royalty payments in the instant case thus are inadequate and based on erroneous assumptions. For past and future periods, royalty owners may succeed in recovery on the basis of "value" even where the producers' filed rates under the Act were lower under contract limitations or Commission orders under Sections 4 and 5 of the Act. Yet, in the instant case, "costs" are based on 1962 "test year" cost levels, which in turn, were based on producers' actual payments in the past. Therefore, the Commission has understated the costs, even under its own opinions; if producers are to pay higher royalty, a "known adjustment" exists, and provision must be made for an upward adjustment in area rates to cover royalty payments exceeding the level of payments actually made in the past.

In any event, the Commission has made inadequate provision for increases in the royalty payments. Suits have already been instituted against producers seeking recoveries on bases far exceeding Commission-prescribed area rates. For example, the State of Texas has filed an original petition in the District Court of Travis County, Texas, 53rd Judicial District, against Mobil seeking recovery on the basis of "market price" instead of Commission-regulated ceiling prices. It is Mobil's understanding that numerous similar petitions have been filed against other producers.

Here, in no event would the 1962 test year figures be correct, and in no event would the computations used for testing rates in the instant case be accurate. Yet, in *Permian*, this Court recognized that royalty payments are to be recoverable in the realization collected through

Commission-prescribed rates, and that principle must be properly applied. The Commission has erred in ignoring the revenue squeeze resulting from its treatment of the issue and in failing to include a provision for upward adjustment in the producer's "applicable area rate" to the extent that the producer is required to make payments of royalty on bases exceeding the producer's filed and effective rates under Section 4 of the Act during any of the time periods covered by the Commission's orders.

The questions of relationship of adequate royalty allowances to prescribed area rates thus also are of national importance warranting this Court's consideration.

4. Provisions for Moratoria Cannot Be Supported By Treatment of Refunds, and Violate The Requirements of *Permian* For Support By Findings As To Future Revenue Requirements

Importance of the predicate for any moratoria on rate increases during the 1970s cannot be overstated. In Mobil's petition as to the Southern Louisiana area rate opinion, Mobil has set forth references to the criteria so spelled out in *Permian* and the reasons this Court should consider the Fifth Circuit's holdings on the question of the predicate for lawful moratoria under Section 4 of the Natural Gas Act.

Here, the freeze would extend to July 1, 1976, but there is nothing in the Commission opinion to support such drastic barring of access to the rate-changing process of Section 4 of the Act in a period of rising costs and volatile economic changes. There also is no "compensation" by significant working capital made available by the refund formula, and nothing by way of findings as to predicted economic conditions to support the moratoria. The court's duty, therefore, was not to speculate as to possible future correction (App. B, pp. 28-29), but to reverse the Commission on this issue. Moratoria cannot

be so drawn from blue-sky, and possible collateral, future relief in other dockets is not a valid ground to sustain the orders on review. *Permian* commanded far more as a basis of findings upon substantial evidence at the time moratoria are imposed.

The question of validity of the moratoria imposed in this case also should be reviewed here.

5. Affirmance of Orders Recognized To Be Defective Raises Major Questions As To Proper Relationships Between The Commission and Reviewing Courts Under Section 19(b) of the Natural Gas Act

Section 19(b) of the Natural Gas Act requires review and reversal by reference to findings of the Commission as to "facts" and support by "substantial evidence". 15 U.S.C. § 717r. Grounds not set forth by the agency cannot be used by a reviewing court to support an affirmance under such statutes. *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156 (1962); *Securities and Exchange Commission* v. *Chenery Corporation*, 332 U.S. 194 (1947). Where an error is laid bare, the reviewing court must reverse and remand and not attempt to provide a new "rationale" or new "support" for an erroneous agency order. *Federal Power Commission* v. *United Gas Pipe Line Company*, 393 U.S. 71 (1968); *Sunray Mid-Continent Oil Company* v. *Federal Power Commission*, 353 U.S. 944 (1957). See also majority opinion by Chief Judge Bazelon in *Texas Gulf Coast Area Natural Gas Rate Cases*, —— F. 2d —— (No. 71-1828, D.C. Cir., decided August 24, 1973), which has been filed as a Supplement to the Appendix to Mobil's Petition for Writ of Certiorari as to the Fifth Circuit's Southern Louisiana opinion.

These requirements have been ignored by the court below. Instead, the court apparently is evolving a departure from the statute under which agency orders based

on inadequate findings and no substantial evidence are affirmed; an "affirmance" is not "final"; and grounds for reversal are passed over by reference to new matter or assumptions that after such "affirmance," the Commission *may* take corrective action, as it sees fit. Questions of what is "final" or not "final" obviously are raised by this approach to agency-court relations.[2] While there is latitude in fashioning remedies and remand directives, the questions of these relations under Section 19(b) as to "equity" powers after an affirmance have not been reviewed by this Court. As the approach is evolving before the Fifth Circuit, there is a conflict with the *United Gas Pipe Line Company*, *Chenery*, and *Sunray* cases cited *supra*, and because of general applicability to all review proceedings under Section 19(b), the questions thus raised need prompt resolution. In addition, such disposition of a patently defective Commission decision clearly conflicts with the requirement for explicit remand directives recognized and applied by the District of Columbia Circuit in *Texas Gulf Coast Area Natural Gas Rate Cases*, —— F. 2d —— (No. 71-1828, D.C. Cir., decided August 24, 1973).

In this instance, the court below also has assumed relief can be accorded by new, untried procedures that are themselves already under attack as to their validity under the Act (App. B, pp. 4, 6, 21). The court likewise has assumed that its "affirmance" leaves no question as to validity of later corrective action by the agency. Yet, under Section 19(b) as heretofore construed here, those assumptions will be subject to question.

Obviously, these questions could have been avoided by proper reversal and remand where error was found,

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[2] See, *e.g.*, *Tacoma* v. *Taxpayers of Tacoma*, 357 U.S. 320 (1958); *International Union* v. *Eagle-Picher Mining & Smelting Company*, 325 U.S. 335 (1945); *United States* v. *Seatrain Lines, Inc.*, 329 U.S. 424 (1951); *Civil Aeronautics Board* v. *Delta Air Lines*, 367 U.S. 316 (1961).

as the District of Columbia Circuit has done. However, the posture in which this case has been left by the court below creates this additional, major question of Commission-reviewing court relations under Section 19(b) of the Natural Gas Act. Clarity as to "finality" of agency orders is essential to the administrative process, and the questions under Section 19(b) raised by the ultimate conclusion reached below thus should be reviewed and resolved by this Court.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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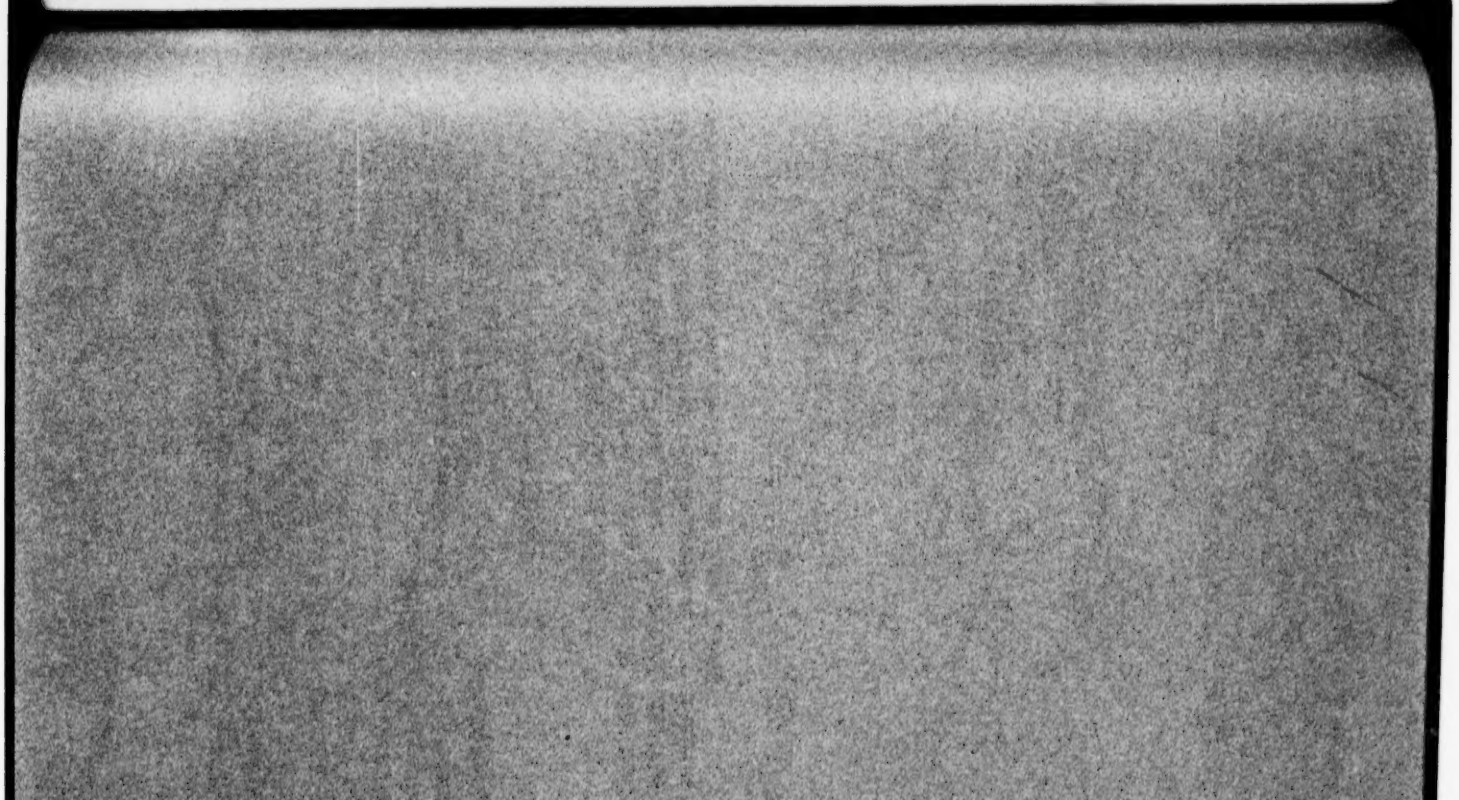
September 6, 1973

APPENDIX A

Judgment of the United States Court of Appeals for the Fifth Circuit, *OSWA I (Shell Oil Company, et al. v. Federal Power Commission)*, Nos. 72-1114, et al., June 8, 1973



UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1972

Nos. 72-1114, 72-1215, 72-1288, 72-1310 and 72-1541
FPC Nos. ZR 67-1 et al

OTHER SOUTHWEST AREA RATE CASE (OSWA I)
SHELL OIL COMPANY, ET AL,
Petitioners,

versus

FEDERAL POWER COMMISSION,
Respondent.

On Petitions to Review and Set Aside Opinions
Orders of the Federal Power Commission

Before BROWN, Chief Judge, BELL and MORGAN, Circuit Judges.

JUDGMENT

This cause came on to be heard on the petitions of Other Southwest Area Rate Case (OSWA I) Shell Oil Company, Et Al for review of orders of the Federal Power Commission of the United States, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the orders of the Federal Power Commission are hereby enforced.

June 8, 1973

Issued as Mandate: July 2, 1973

A true copy

Test: EDWARD W. WADSWORTH
Clerk, U.S. Court of Appeals, Fifth Circuit

By /s/ Maryette Farley
Deputy July 2, 1973
New Orleans, Louisiana

APPENDIX B

Opinion of the United States Court of Appeals for the Fifth Circuit, *OSWA I (Shell Oil Company, et al. v. Federal Power Commission)*, Nos. 72-1114, et al., June 8, 1973

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Nos. 72-1114, 72-1215, 72-1288, 72-1310 and 72-1541

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versus

FEDERAL POWER COMMISSION,
Respondent.

On Petitions to Review and Set Aside Opinions and Orders of the Federal Power Commission

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(June 8, 1973)

Before BROWN, Chief Judge, BELL and MORGAN, Circuit Judges.

BROWN, Chief Judge: This case involves rates fixed by FPC on October 29, 1971, for the so-called Other Southwest Area, and now joins *SoLa I* and *SoLa II* as *OSWA I.*

Following the mandate of the United States Supreme Court in *Phillips Petroleum Co.* v. *Wisconsin,* 1954, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035 (Phillips I), FPC began its long and winding journey toward the effective regulation of the rates at which producers of natural gas in interstate commerce may sell their gas at the well-head. After several years' attempts to regulate

producers individually based upon their individual costs-of-service, FPC determined to establish the "just and reasonable" maximum rates for the well-head sales of gas on an area-by-area basis. See *Wisconsin* v. *FPC*, 1963, 373 U.S. 294, 83 S.Ct. 1266, 10 L.Ed.2d 357 (Phillips II). This method was explicitly approved by the Supreme Court in The Permian Basin Area Rate Cases, 1968, 390 U.S. 747, 88 S.Ct. 1344, 20 L.Ed.2d 312, and by us in *Austral Oil Co.* v. *FPC*, 5 Cir., 1970, 428 F.2d 407 (*SoLa I*), and again in *Placid Oil Co.* v. *FPC*, 5 Cir., 1973, —— F.2d —— [No. 71-2761, April 16, 1973] (*SoLa II*). *Accord, Hugoton-Anadarko Area Rate Case, California* v. *FPC*, 9 Cir., 1972, 466 F.2d 974.

And before the last slug falls in the St. Paul linotype on this opinion area rate regulation may too be forgotten if not abandoned. For FPC has very recently announced its hopeful purpose to set uniform rates for the nation as a whole under its rule-making powers.[1] So though we write with the realization that the regulatory

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[1] See Notice of Proposed Rulemaking (April 11, 1973), Docket No. R-389B, 38 Fed. Reg. 10014 (April 23, 1973), [Foster Associates Report No. 891].

FPC first used the abbreviated technique of rule-making for gas rate regulation in the Rocky Mountain Area. After the Tenth Circuit approved the procedure in Phillips Petroleum Co. v. FPC, 10 Cir., 1973, —— F.2d —— [No. 71-1659, February 20, 1973], FPC established rates for that area in The Rocky Mountain Area Rate Case, Op: 658 (April 11, 1973), 49 F.P.C. ——, 38 Fed. Reg. 9802 (April 20, 1973). On the same day it announced its intention of setting maximum "just and reasonable" rates for the well-head sales of natural gas for the nation as a whole by July 1, 1973.

Significantly, FPC declined to set new gas rates for the Rocky Mountain Area in Op: 658 in deference to its intent to cover that subject nationally in Docket No. R-389B.

FPC's announced purpose of using rulemaking was to avoid the unnecessary delay and rate uncertainty which is attendant upon "protracted adjudicatory proceedings and subsequent court litigation". FPC hopes the new procedure will provide the needed flexibility to effectively cope with major changes and national problems—like the current gas shortage crisis.

approach may soon change, we are nevertheless mindful that we must play our role.

In the present case, we are called upon the review FPC Opinion 607 (Op: 607) which purports to establish the "just and reasonable" rate ceilings for the so-called "Other Southwest Area" (OSWA).[2] Because of the similarity in proceedings and heavy reliance by FPC on its *SoLa II* approach in Op: 607, many of the legal issues which we are required to decide to effectively review this case are controlled by our decision in *SoLa II*.[3] Yet,

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[2] Actually, not only is OSWA not "Other" Southwest, it is not "Southwest" at all.

OSWA is a heterogeneous amalgamation of six geographically, geologically, and economically distinct sub-areas lumped together by FPC for administrative, regulatory convenience. It includes all of (1) Arkansas and (2) Mississippi, (3) "Other" Oklahoma (the 56 counties in southern and eastern Oklahoma not covered by FPC's order in the Hugoton-Anadarko Area Rate Case), (4) Texas Railroad Commission Districts Nos. 5, 6 and 9, (5) four counties in northwest Alabama, and (6) all of Louisiana north of the 31° parallel (that part not covered by FPC's order in *SoLa* II).

Separate "sub-area" treatment was also given to Mississippi's offshore reserves. See note 5, *infra*.

The major geological feature of OSWA is the Ouachita Front, a fault in the earth arcing northward from northeastern Mississippi into Arkansas and then westward and southerly to the Big Bend area of Texas. Oil and gas above the fault are produced from the ancient rocks of the Paleozoic era, while production below the fault comes from the relatively young rocks of the Mesozoic and Cenozoic periods.

And the geological distinctions do not even divide themselves at this juncture, for within these two categories there are a myriad of uplifts, basins, synclines, and the like.

[3] Specifically, several of the petitioners have challenged (i) FPC's establishment of October 1, 1968 as the division date between so-called "flowing" gas and "new" gas, (ii) FPC's determination that casinghead gas, i.e., gas produced in conjunction with oil, is to be treated the same way for regulatory purposes as gas-well gas of the same vintage, and (iii) FPC's failure to make special provisions for producers whose *Erie*-uncontrollable royalty obligations might exceed FPC's current projections, see Mobil Oil Corp. v. FPC, D.C. Cir., 1972, 463 F.2d 256, *cert. denied sub. nom.*, 1972, 406 U.S. 976, 92 S.Ct. 2409, 32 L.Ed.2d 676, reversing FPC's ruling after our

OSWA's lack of total homogeneity in the various geographical production areas and FPC's approach to them compels us to examine several aspects of Op: 607 in detail.

The Op: 607 Rate Structure

The maximum rates at which natural gas may be sold in OSWA, according to the terms of Op: 607, depends on two factors: the "vintage" [4] of the gas and the particular OSWA sub-area from which it is produced. There are three vintages of gas based upon the date of the contract under which the gas is committed to the interstate market—pre-1961 gas, 1961-68 gas, and post-1968, "new" gas. Within these categories the maximum gas rates for OSWA may vary according to the sub-area of production as follows:

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initial primary jurisdiction reference to it, J. M. Huber Corp. v. Denman, 5 Cir., 1966, 367 F.2d 104; Weymouth v. Colorado Interstate Gas Co., 5 Cir., 1966, 367 F.2d 84. Because of the extended review which we gave these matters in *SoLa II*, these provisions of Op: 607 are enforced without further discussion.

Of course, *SoLa II* is also helpful in our determination of the other legal issues presented in this case, including the costing methodology employed by FPC to determine both new and flowing gas rates, the provision which allows for a refund discharge through the commitment of new reserves to the interstate market, and the Op: 607 moratorium on increased rate filings under § 4(e) of the Act until October 1, 1976. But we shall speak more of these anon.

[4] We discussed the anomaly of determining the vintage on the basis of the date of sale in *SoLa II:* p. —— n. 9. Interestingly, the "vintage" of casinghead gas is determined, not by the date of the contract first committing it to the interstate market, but rather by the date of discovery. See Op: 607A, ¶ 2.

In its recent Appalachian and Illinois Basin Area Rate Case, Op: 639, —— F.P.C. ——, now pending review in the Fifth Circuit, Docket No. 73-1329, FPC took steps to eliminate the "vintaging" of gas by providing that new gas rates shall be applicable, to the extent allowed by contract, to successor contracts between previously contracting parties. Both Order 455 and the proposed rulemaking in Docket No. R. 389B, see note 1, *supra*, also abandon the date of contract anomaly by tying the maximum permissible rate to the date of the well. But these administrative decisions must run the course of judicial review, and we note them only in passing.

—pre-1961: 14.4¢/Mcf to 19.0¢/Mcf

—1961-68: 17.25¢/Mcf to 19.0¢/Mcf

—post-1968: 22.5¢/Mcf to 25.0¢/Mcf [5]

Of course rates are the major work-product of a rate case. But in OSWA, as in all of FPC's other rate cases, there were a number of administrative appendages to the rate structure. These included:

—a program to allow producers owing refunds to work off this obligation by commiting new reserves to the interstate market,

—a moratorium on increased rate filings under Sections 4(e) of the Natural Gas Act for OSWA until July 1, 1976,

—a 1.0 to 1.5¢/Mcf adjustment for ungathered gas,
—quality adjustments according to Btu content, and

—"small producer" exemptions and special dispensation procedures.

Our review of the case convinces us that these provisions should be sustained in full.

Yet, we must confess our bewilderment in light of FPC's current approach to rate regulations, especially its actions in *SoLa II* and Texas Gulf Coast,[6] with the

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[5] OSWA includes the as yet untapped gas potential of the offshore federal domain contiguous to the Mississippi shoreline. In order to maintain parity with production from the federal domain lying off the southern shores of Louisiana, FPC established the same rates—26¢/Mcf with a 1¢/Mcf escalation on October 1, 1974—for the Mississippi off-shore domain as in *SoLa II*. For the reasons we stated in *SoLa II:* p. —— and n. 24, we enforce this determination without further discussion.

[6] Rates for the prolific Texas Gulf Coast Area were established by FPC on May 6, 1971, in Op: 595, 1971, 45 F.P.C. 674, now pending review in the D.C. Circuit. New York Public Service Commission v. FPC, Docket No. 71-1828.

[Footnote continued on page 8]

rates established for "flowing" gas. As some of the producer-petitioners point out, unlike *SoLa II* which was based entirely on 1969 cost data, most—if not all—of these rates were established on the basis of 1962 cost data. Although on an examination of quality-pressure-geographic differentials we are convinced that in so doing FPC acted within the "zone of reasonableness", which we accord to administrative action, we must in light of this evidence cast our enforcement of this aspect of Op: 607 —as we did in *SoLa I*: 444 F.2d 125 (on rehearing)— in a manner which gives FPC maximum flexibility to alter the rates established for flowing gas by Op: 607 both prospectively and retroactively as it deems necessary in light of existing market data. With this emphasis we give full enforcement to Op: 607.

Supply And Demand In OSWA

In *SoLa II* we chronicled the details of our current critical supply shortage of natural gas and other energy sources. As we pointed out, the proliferating national demand for natural gas has already outstripped available supply.[7] One need not consult an oracle to determine that, unless severe steps are taken to encourage exploitation of domestic reserves of natural gas, the future portends an even greater supply deficit. When it concluded its regulatory undertaking for OSWA in October 1971, FPC was conscious from its prior rate cases of the magnitude of this supply crisis.

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[6] [Continued]

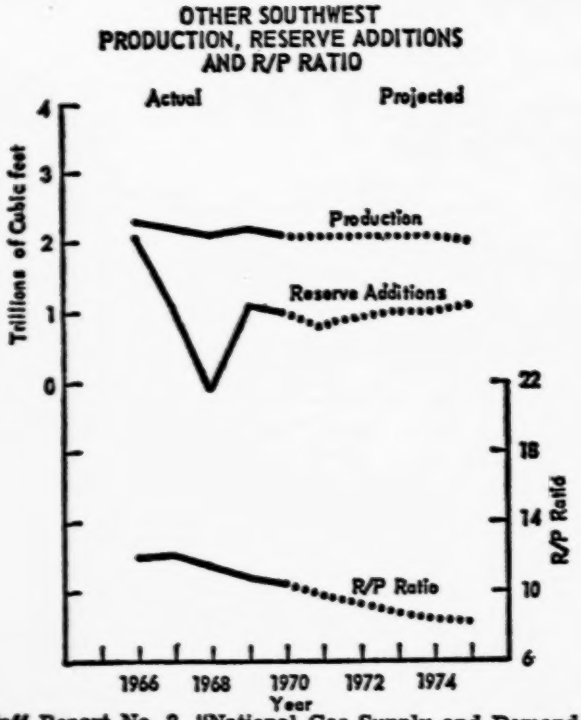
FPC's opinion in *SoLa II* followed close on its heels. Op: 598, 1971, 46 F.P.C. 86, was rendered on July 16, 1971.

It is important to put OSWA into this temporal perspective. Op: 607, 1971, 46 F.P.C. 900, was issued on October 29, 1971, just 71 days after *SoLa II* and only 176 days after Texas Gulf Coast.

[7] The Reserves-to-Production (R/P) ratio for OSWA declined from 11.0 in 1964 to 9.8 in 1969. This decline was largely due to inadequate findings. The Findings-to-Production (F/P) ratio has been below unity since 1965. Staff's projections indicate that this trend will continue:

Recognizing the applicability of national and other area data to OSWA, FPC began by carefully assessing OSWA.

> "Other Southwest" is not a homogeneous area. Each of the four areas covered by previous area rate proceedings was generally similar throughout, with some deviations, in geology, pricing history and markets served by the gas produced in the area concerned. Other Southwest, on the other hand, has a variety of pricing histories in its different sub-areas, the geology varies in different sub-areas, and the gas produced in Texas District 9, Other Okla-



Staff Report No. 2, "National Gas Supply and Demand, 1971-1990," (February 1972).

homa and northwestern Arkansas goes to different markets than gas produced in other sub-areas. The importance of the intrastate market varies in the various sub-areas. The age of development and the potential for future development also differ widely throughout the Other Southwest area. For these reasons, we shall consider the various sub-areas separately, stating in each instance the facts relevant to our particular determination.

Op: 607, ¶ 4.

Annual production from OSWA has remained relatively constant at about 1.2 Tcf since 1956. But, because of the increasing national consumption of natural gas since that time, OSWA's percentage share of the national market declined from 19.6% in 1956 to 13% in 1963, and 9% in 1969. Exploratory efforts have decreased significantly in the last decade, though the potential for the area gives cause for hope.[8]

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[8] Several producers contend that FPC has failed to take a full account of the potential for natural gas production from OSWA. Staff credits the data of the Potential Gas Committee (PGC) which makes the following projections for OSWA. There are about 86 Tcf of potential natural gas reserves. This figure is about four times the proven reserves of the area and comprises approximately 10.1% of the reserve potential for the lower 48 contiguous states. The amount is estimated by PGC to be divided into two depth categories so that 73 Tcf are above 15,000 feet with only the remaining 13 Tcf between 15,000 and 30,000 feet. The real uncertainty which enshrouds OSWA's potential becomes apparent from the categorization of these reserves: (i) only 10 Tcf (about 11.6% of the potential) are in the "probable" category, while (ii) 23 Tcf (about 26.8%) are "possible", and (iii) 53 Tcf (61.6%) are "speculative".

The producers, however, suggest that even this somewhat optimistic view fails to include all of the areas encompassed within OSWA. According to their approximations, based upon data from the Potential Gas Agency at the Colorado School of Mines, OSWA has a total potential of some 164 Tcf—13 probable, 40 possible, and 111 speculative. Given this substantial deviation from FPC's factual premise, these producers conclude, "To the extent that the Commission's unduly low area ceiling rates were predicated on

The quality of the gas in OSWA is generally inferior to that of the other major producing areas by any parameter—Btu, pressure, or purity. Also of major significance is the fact that at least 40-45% of production in OSWA is diverted to the intrastate market.[9] Based

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the assumption that the area contains a minimal potential, clearly such finding is erroneous and must be set aside."

While we are pleased to hear that OSWA's potential might exceed current estimations by FPC, we fail to see how this makes any difference in our review of the case since FPC established a rate structure which according to its own words would "fully utilize" the resources of OSWA.

[9] And even this broad statement is somewhat misleading. Focusing on this one particular aspect of OSWA's total factual picture gives some indication of the wide variances from sub-area to sub-area within OSWA.

FPC acted on the basis of the following data with respect to intrastate sales:

[7] Reports (Form 15) filed by pipelines with the Commission indicate jurisdictional sales of 1.210 trillion cubic feet in 1969, or 56.2 percent of the 2.152 trillion feet of production reported by the American Gas Association (AGA) for 1969 in the Other Southwest Area.

By sub-areas, the comparable figures in billions of cubic feet are:

	AGA Production	Form 15 Sales	Percentage
Other Oklahoma	592	260	44
Texas R.R. Dist. 9	181	60	33
Arkansas	166	138	83
Texas R.R. Dist. 6	437	217	50
Northern Louisiana	488	410	84
Mississippi	166	125	75

All sales in Texas R.R. District 5 were intrastate in 1969, although there have been some interstate sales this year. No statistics are available for Alabama, but the volume is very small. The percentages are subject to a slight distortion because AGA production includes gas used in the field and never sold.

Thus, the competitive effect of intrastate rates on interstate ceilings would be a critical factor in Texas or Oklahoma where the intrastate market claimed from 50-100% or 56% of production respec-

upon this data, FPC set rates for the various sub-areas of OSWA.

A Closer Look At Op: 607

In *SoLa II* FPC targeted a goal of 45 Tcf production from the Southern Louisiana Area for a five year period. It then established a rate structure which it believed would be a reasonable incentive to motivate producers to produce and dedicate that particular amount.[10] In OSWA, on the other hand, FPC began from the premise that OSWA production would never meet demand:

> "While we cannot expect that this area will be able to supply the potential demand upon it, it is important that its potential be fully utilized in this time of national need for all available gas."

Op: 607, ¶ 10. FPC projected that 11 Tcf of new reserve additions would be required over the next five years to

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tively, but relatively insignificant in Northern Louisiana or Mississippi where only 16% or 25% of production was diverted to intrastate consumption.

These factual deviations are indicative of the complexity of FPC's task in OSWA. It is because of such matters that reviewing courts assess administrative actions under such rubrics as "end result," "zone of reasonableness," and even "kid gloves." See generally, *SoLa II*; p. —— [slip op. pp. 7-13].

[10] FPC adopted a triumvirate of incentives in *SoLa II*. First, the rate structure itself—particularly the 26¢/Mcf rate for offshore gas—was calculated to bring forth 15 Tcf. Second, FPC adopted a program by which producers could work-off the $150,000,000 refund obligation at the rate of 1¢/Mcf for each new Mcf of gas committed to the interstate market, in hope of producing another 15 Tcf. Third, FPC allowed for a contingent serial escalation of 1½¢/Mcf on flowing gas rates in half-penny intervals when the industry as a whole committed 7½, 11¼, and 15 Tcf of SoLa production to the jurisdictional market.

In Op: 607 FPC initially put all the eggs in the rate basket for OSWA. But on rehearing it decided to allow the same credit against refund obligations which it had used in *SoLa II*. Op: 607A, ¶ 4.

meet the extrapolated demand for inter and intrastate gas. As in *SoLa II*, FPC was unable or unwilling to quantify the relationship between the rates it established and the likely response of market forces.

> There is no reliable evidence to indicate the amount of new gas reserves that would be discovered as the result of any specific change in rates, nor evidence as to the amount of such reserves that would be dedicated to the interstate market. We estimate that this area has probable reserves of from 15 to 18 trillion cubic feet still to be discovered. The prices established herein provide incentives, however, to the producers in this marginal area to find gas and dedicate it to interstate commerce. The prices established will enable the interstate market to compete in price with the present and potential intrastate buyers in the area.

Op: 607, ¶ 13.

In spite of the strenuous arguments of several producers to the contrary, it is clear that FPC—in a line with the approach it has taken in *SoLa II* and the Texas Gulf Coast Area Rate Case—used the average cost determinations for the production of natural gas in OSWA as a flexible point of departure. Op: 607, ¶ 16. In both *SoLa II* and Texas Gulf Coast, FPC held that this point of departure would "flex" about 4¢/Mcf. See *SoLa II*: p. —— n. 23. And, as FPC pointed out, that point of departure is even harder to ascertain when the administrative agency has to compute costs on the basis of an area which is a heterogeneous amalgamation of separate subareas:

> Cost computations are notoriously imprecise. Where the districts on which the computations are based are as small as they are here, it becomes even more questionable whether the computed costs are representative.

Op: 607, ¶ 34.

Basically, FPC used the same approach here as in *SoLa II*, that is, to price new gas on the basis of national, published data, but to price flowing gas on the basis of regional, historic data. In addition to the supply and demand information available to it and the costing data for the area as a whole, FPC also established as points of reference the various sub-area costs, the levels of both inter and intrastate prices, and the prices of gas in the adjacent producing areas. See Op: 607, ¶ 16.

Taking all of these factors into account it established a three-tiered rate structure as approved by the Supreme Court in *Permian*. There were two "vintages" of flowing gas—the first being composed of gas committed to the interstate market under a contract signed prior to January 1, 1961, and the second being gas committed to the interstate market by a contract dated between January 1, 1961 and September 30, 1968.[11] All gas committed under a contract dated after October 1, 1968 was third vintage or so-called "new" gas.

The rates established for pre-1961 gas varied from 14.4¢/Mcf to 19.0¢ Mcf (with periodic, automatic escalations) depending on the sub-area of production.[12] The

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[11] Actually, with respect to the Mississippi and Alabama sub-areas of OSWA, there was only one vintage of "flowing" gas. The rate for that gas was 19.0¢/Mcf, but it was subject to half-penny automatic escalations on January 1, 1965 and again on October 1, 1968.

[12]

	Prior to January 1, 1965	From January 1, 1965 Through September 30, 1968	From October 1, 1968
Other Oklahoma	17.5	18.4	19.4
Texas Railroad District No. 9	17.8	18.7	19.7
Northern Arkansas	17.0	17.9	18.8

[Footnote continued on page 15]

maximum permissible rates for 1961-68 gas ranged from 17.25¢/Mcf to 19.0¢/Mcf (with half-penny escalations on January 1, 1965 and October 1, 1968).[13] The rates for post-1968 "new" gas ranged from 22.5¢/Mcf to 25.0/Mcf.[14] These three sets of rates comprise the entire rate structure for OSWA.

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[12] [Continued]

Texas Railroad District No. 6	15.0	17.0	19.1
Northern Louisiana (at 15.025 psia)	16.7	18.6	20.6
Southern Arkansas	14.4	16.25	18.25
Mississippi and Alabama (at 15.025 psia)	19.0	19.5	20.0

[13]

	Prior to January 1, 1965	From January 1, 1965 Through September 30, 1968	From October 1, 1968 Until January 1, 1972
Other Oklahoma	18.4	18.9	19.4
Texas Railroad District No. 9	18.7	19.2	19.7
Northern Arkansas	17.8	18.3	18.8
Texas Railroad District No. 6	18.1	18.6	19.1
Northern Louisiana (at 15.025 psia)	19.6	20.1	20.6
Southern Arkansas	17.25	17.75	18.25
Mississippi and Alabama (at 15.025 psia)	19.0	19.50	20.0

[14]

Texas District 9	24
Northern Arkansas	23
Other Oklahoma	23.75
Texas Districts 5 and 6	23.5
Southern Arkansas	22.5
Northern Louisiana	25
Mississippi and Alabama [18]	25

What's Wrong With The Rates

The major producers [15] vigorously attack the Op: 607 rate structure set by FPC for OSWA. Their principal complaint is that the rates are not high enough. Groping for a legal theory on which to base this economic lamentation, they raise several issues. First, the majority of the major producer-protesters, the "Shell Protestants," suggest that FPC's continued use of cost-of-service as a point of departure can no longer be justified. Mobil joins this group in making its second argument that FPC has failed to take full account of the competitive effect of intrastate prices in establishing the permissible ceilings for OSWA interstate rates. Finally, the entire array of producers makes the general assertion that in several particulars the rate structure is not supported by the evidence in the record.

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[15] Led by the named petitioner, the Shell Oil Company, the primary group of producers challenging the Op: 607 rate scheme includes the Amoco Production Co., the California Co., Continental Oil Co., Gulf Oil Corp., Humble Oil & Refining Co. (now Exxon), Signal Oil & Gas Co., the Superior Oil Co., and Texaco, Inc.

Aligned on the brief with these petitioners are intervenors Amerada Hess Corp., Ashland Oil, Inc., Atlantic Richfield Co., the Marathon Oil Co., Murphy Oil Corp., Skelly Oil Co., Sun Oil Co., Tenneco Oil Co., and the Union Oil Co. of California.

For convenience's sake we shall refer to this group as the "Shell Protestants."

Mobil appears as a loner challenging virtually every utterance of FPC.

Shell, Signal, the California Co., and all of their intervenor-friends—on the other hand—have intervened against Mobil's petition to the extent that it challenges (i) the refund-discharge provisions of Op: 607A, (ii) FPC's decision to price casinghead gas on par with contemporary gas-well gas, and (iii) the "new" gas division date of October 1, 1968.

From FPC's point of view Exxon may have changed its stripes along with its name. See *SoLa II:* p. —— n. 27. In *SoLa II*, with the exception of Mobil and Amoco, nearly all of these producers supported FPC's holding. Here they attack it. Of course the difference may lie largely in the fact that *SoLa II* was written according to the terms of a settlement compromise.

Cost-of-service: A Point Of Departure

The thrust of the Shell Protestants' first argument is that because of the current supply shortage, it is administratively inappropriate for FPC to continue to use the "lowest reasonable level" [16] method of determining "just and reasonable" rates. In this context they argue that the reasonability of rates should be determined by comparison to the rates for alternative, substitute or competitive fuels rather than from calculations based upon a cost-of-service with a rate of return sufficient to serve as an incentive for new production. In short, the producers apparently call for regulation of rates by market forces alone—the law of the jungle! [17]

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[16] FPC has also rejected the notion that it should use "lowest reasonable cost." In George Mitchell and Associates, Op: 649, "Opinion and order granting special relief and terminating proceedings, —— F.P.C. —— (Feb. 21, 1973) it said:

> "Lowest reasonable cost" has no meaning in regulation unless its determination encompasses consideration of reliability and adequacy of supply. If we are so concerned with price as a measure of profit that we ignore the effect of price on supply, we fail in our essential function.

FPC is using cost-of-service, but only as a point of departure.

[17] We do not mean to intimate, however, that the level of substitute or competitive fuel prices is not a probative factor in making the required determination of the propriety of the "end result." See FPC v. Hope Natural Gas Co., 1944, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333; The Permian Basin Area Rate Cases, 1968, 390 U.S. 747, 88 S.Ct. 1344, 20 L.Ed.2d 312; *SoLa II*.

Nor do we hold that FPC could not, under the structure of the Act conclude that, in the light of record evidence, rates at the level of those for competitive fuels would be "just and reasonable." This is far from the contention that on this epicodic record covering a heterogeneous amalgamation of geographically unrelated areas FPC was compelled as a matter of law to do so. But these are matters for another day.

FPC is charged by the Natural Gas Act with the responsibility for regulating the well-head sales of gas. Of course it would be possible to amend the act in favor of total deregulation, and the current administration has proposed a bill to do just that with

We recognized in *SoLa I* that market conditions might well justify FPC in adding non-cost incremental incentives to the rate structure. But the mere presence of a supply crisis does not compel FPC to wholly abandon a costing methodology as it carries out its responsibility to determine "just and reasonable" rates. What the producers assert as an economic proposition (and then seek as a principle of law) is that total freedom from any effective administrative regulation of rates is the only solution for the energy crisis at hand.

In *SoLa II* we examined at length FPC's current approach to costing methodology. *SoLa II:* notes 6, 19, 23. We recognized and sanctioned FPC's administrative discretion in fixing a particular rate which falls within the "zone of reasonableness" of the entire matrix of cost components. But in focusing on the "end result" and according appropriate deference to the administrative choice in light of the great flux in cost determinations,[18] we will not allow our scrutinizing of the whole to eclipse a consideration of the parts. Administrative discretion is not tantamount to synergistic legerdemain. We must decide whether FPC has erred in including, excluding, or evaluating components of the rate structure to determine if the particular error washes out in the "zone of reason-

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respect to new gas. See H.R. 7507, 93rd Cong., 1st Sess. (1973) (Introduced by Congressman Staggers on April 18, 1973). But until this obligation is lifted from FPC, it must determine as an administrative matter, the manner in which it will regulate.

[18] FPC has repeatedly recognized the imprecision of costing calculations. In *SoLa II*; p. —— n. 23 we quoted from FPC's Texas Gulf Coast Area Rate Case, Op: 595, 1971, 45 F.P.C. 674, 687. It bears repeating:

> "The cost computations used in this and other area rate proceedings seem to be mathematically precise. They are not. Allocations of costs are by nature matters requiring a substantial amount of judgment."

See also, *SoLa II*; p. —— n. 19.

ableness," or has such significance that the result is unacceptable.

Competitive Rates: Op: 607 and The Intrastate Market

The first of these factors is the producers' contention that FPC has failed to take adequate account of the effect of intrastate rates, as updated with new data—on the OSWA rate structure.

Using the table taken from the Shell Protestants' initial brief the current weighted average of intrastate sale prices is 25.21¢/Mcf.[19] The sub-area breakdown of intrastate rates for OSWA provides a further basis for comparisons with the rates set by FPC in Op: 607.[20]

A careful examination of these rates shows that the "new" gas rates established by Op: 607 exceed the weighted average of current intrastate sales in every sub-area except Other Oklahoma. In response to this cold hard fact, the Shell Protestants suggest in their reply brief

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Area	1969 Annual Volume (Bcf)	1969 Current Price a/ Wtd. Avg. (¢/Mcf)	1969 Current Price a/ Range (¢/Mcf)	First Half 1970 Annual Volume (Bcf)	First Half 1970 Current Price a/ Wtd. Avg. (¢/Mcf)	First Half 1970 Current Price a/ Range (¢/Mcf)	7/1/70 And Later Annual Volume (Bcf)	7/1/70 And Later Current Price a/ Wtd. Avg. (¢/Mcf)	7/1/70 And Later Current Price a/ Range (¢/Mcf)
Permian Basin	146	14.57	8.26-23.99	103	21.47	15.60-23.07	137	23.90	8.96-28.50
South Louisiana	10	20.38	19.50-23.68	72	22.98	20.50-30.00	25	26.22	20.25-39.56
Texas Gulf Coast	148	19.39	12.05-22.13	38	18.39	10.50-24.38	75	22.19	11.00-30.11
Bugotoo-Anadarko	6	17.32	15.00-19.33	13	21.55	18.00-24.04	45	22.65	9.25-35.36
Other Southwest	7	17.85	12.27-21.45	12	18.69	14.00-21.53	52	25.21	4.40-28.92
Rocky Mountain	0.7	11.57	9.75-12.00	8	18.05	6.83-19.01	20	17.32	6.00-25.00
California	9	31.26	25.00-35.25	1	30.43	25.00-31.00	11	34.09	27.00-37.00
Michigan	1	38.00	35.70-43.72	4	36.00	36.00	19	40.87	36.00-48.30

a/ Inclusive of tax reimbursement, additive and deductive adjustments for gathering and Btu. The prices for the contracts dated in 1969 and the first half of 1970 are as of August 1970; the prices for subsequent sales are as of September 1971.

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Area	1969 Annual Volume (Bcf)	1969 Current Price a/ Wtd. Avg. (¢/Mcf)	1969 Current Price a/ Range (¢/Mcf)	First Half 1970 Annual Volume (Bcf)	First Half 1970 Current Price a/ Wtd. Avg. (¢/Mcf)	First Half 1970 Current Price a/ Range (¢/Mcf)	7/1/70 And Later Annual Volume (Bcf)	7/1/70 And Later Current Price a/ Wtd. Avg. (¢/Mcf)	7/1/70 And Later Current Price a/ Range (¢/Mcf)
Arkansas	0.2	16.00	16.00	0.2	18.75	18.75	—	—	—
North Louisiana	2.7	21.45	21.45	—	—	—	0.3	20.38	19.50-21.45
Mississippi	—	—	—	1.0	20.96	20.96	—	—	—
Oklahoma	0.5	16.06	15.00-18.27	1.6	15.86	14.00-16.00	37.8	27.13	11.17-28.92
Texas District 3	1.9	13.91	12.27-17.44	1.0	18.50	18.50	9.9	21.80	18.00-27.45
Texas District 6	1.6	17.14	16.08-17.44	7.1	18.67	17.50-19.00	4.0	13.72	4.40-18.30
Texas District 9	—	—	—	0.9	21.53	21.53	—	—	—

a/ Inclusive of tax reimbursement, additive and deductive adjustments for gathering and Btu. The prices for the contracts dated in 1969 and the first half of 1970 are as of August 1970; the prices for subsequent sales are as of September 1971.

that while this may be true, FPC-determined interstate rate ceilings should correlate with maximum rather than weighted average intrastate rates. No court has held—and we do not hold today—that intrastate rate levels are a mandatory component of the interstate rate scheme. Nor do any of the producers claim that, as a matter of law, they are. FPC obviously considers this one of the relevant factors since the competition from non-federally regulated intrastate purchases affects quite directly the total available supply for both intra and inter state gas.[21] From an administrative point of view, buttressed as it would be by business practices, the use of maxima might well be both unmanageable and distorted.

The time has come for courts to recognize that there is a myth in much of the figures. Weighted averages are certainly permissible. In Op: 607 FPC took a realistic look at intrastate rate levels, and we can find no great incongruity between the rates set for OSWA and the prevailing rates in the intrastate market.

New Rates For New Gas

As to the contention of the producers that there is no record evidence to support the rates established by Op: 607 for new gas in OSWA, we must say that our reading of the record does not leave this impression. FPC was entitled to consider national cost data available to it and offered in the context of other area rate proceedings when it fashioned a rate schedule for OSWA. Two of these other rate schedules have already been sustained on judicial review. See *SoLa II;* Hugoton-Anadarko Area Rate Case: *California* v. *FPC*, 9 Cir., 1972, 466 F.2d 974. Given the experienced judgment which came from dealing with these cases as well as the record evidence

[21] As we have previously pointed out, the weight which this factor has, from a purely economic standpoint, varies drastically from sub-area to sub-area within OSWA. See note 9, *supra*.

of the instant proceeding, FPC was empowered to make a choice of costs from the permissible zone.

In *SoLa II*, Part VII, we examined several alternative channels of relief for a producer whose special circumstances warranted higher rates than the maximum allowed by the area rate proceeding which served as anchors-to-windward. Of course all of those special relief procedures are equally applicable here. And there is a substantial indication that they are being exploited.[22] But we are also aware that—as far as the future pricing of "new" gas is concerned—area rate regulation as a regulatory method may be near to an end. For as we have previously noted FPC has issued a notice of a proposed rule-making[23] to establish "just and reasonable" rates for the well-head sales of natural gas on a national basis. While neither the terms nor the validity of this proposal are before us now, all must be aware of the administrative decision to exercise the prospective powers of § 5 of

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[22] George Mitchell and Associates, Op: 649, "Opinion and order granting special relief and terminating proceedings," —— F.P.C. —— (Feb. 21, 1973) was such a proceeding granting special relief to a producer in OSWA. The readiness of FPC to entertain such petitions and the effectiveness with which they are processed bolsters the reassurance which we expressed in *SoLa II*, Part VII.

[23] Of course, we make no intimations as to the validity of the rulemaking process as a procedural issue or the national rate concept as a legal issue at this juncture. We note that our Brothers of the Tenth Circuit have sanctioned the informal rule-making device as an acceptable procedural mechanism for the determination of "just and reasonable" rates for the Rocky Mountain Area. See Phillips Petroleum Co. v. FPC, 10 Cir., 1973, —— F.2d —— [No. 71-1659, Feb. 20, 1973]. See note 1, *supra*.

Rule-making was also used in Op: 639, —— F.P.C. ——, now pending review in Fifth Circuit Docket No. 73-1329, relegating producers in the Appalachian and Illinois Basin Area to the optional procedures of FPC Order No. 455, "Statement of Policy Relating To Optional Procedural for Certificating New Producer Sales of Natural Gas," promulgating 18 C.F.R. § 2.75 (August 3, 1972), now pending judicial review in the D.C. Circuit, Moss v. FPC, [No. 72-1837] and APGA v. FPC [No. 72-1846], for increased rates on new gas.

the Natural Gas Act, 15 U.S.C.A. § 717d, within a healthy regulatory framework to elicit necessary supply. In announcing its decision FPC expounded somewhat on its current approach:

> "We use cost as a basis for departure, as suggested in *City of Detroit*, although we recognize the inherent imprecisions contained in such an approach. We will look toward a range of just and reasonable costs and rates of return. We will likewise consider numerous non-cost factors, including supply and demand and consequences upon the producing industry of the rate order. We will also consider the capital required to conduct the necessary exploration and development effort, prices of alternative fuels, prices of supplemental gas sources, intrastate contract rates, and the commodity value of natural gas. The end result will be a just and reasonable rate designed to maintain and assure adequate service to consumers and to attract the necessary capital to maintain gas exploration, . . . and production, at a level which will serve consumer needs." [24]

Our review of the costing evidence in the record,[25] the correlation between new gas rates and intrastate rates, the levels of substitute fuel prices, and other factors

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[24] Notice of Proposed Rulemaking (April 11, 1973), Docket No. R-389B, 38 Fed. Reg. 10014 (April 23, 1973) [Foster Associates Report No. 891 at 3].

[25] For example, one major cost component is the drilling data—cost and yield per foot. In *SoLa II* FPC found that "drilling costs per foot should range upward from about $25.00 per foot," and that "productivity estimates should cluster around 600 Mcf per foot drilled." Op: 598. ¶¶ 120-21. No one challenges the additional finding that drilling costs vary greatly with the depth.

The producers suggest, however, that $30.00/foot would be the appropriate drilling cost figure to use for OSWA. [Shell initial brief, at p. 50]. There is no compelling record evidence that a different figure should be used for OSWA than for *SoLa*. This is especially true when one considers the fact that 73 Tcf of the FPC estimated 86 Tcf reserve potential of OSWA are above 15,000 feet. See note 8, *supra*.

leads us to conclude that FPC has set new gas rate ceilings at a permissible point within the "zone of reasonableness". The availability of individual relief and the possibility of FPC action setting national rates for new gas, while not a basis for our enforcement of Op: 607, do furnish solace to the Court. The Op: 607 rate structure for "new" gas is sustained in full.

Flowing Gas

Both Mobil and the Shell Protestants raise essentially three points to contest the rates for flowing gas: (i) FPC adopted the Administrative Law Judge's proposed rates for flowing gas without adjusting the rate of return component from 10.5% to 15.0% as it had done for new gas; (ii) FPC failed to include an exploration and development adjustment, and (iii) FPC returned to the Btu method of allocating expenses between oil and gas produced in association.

Using cost merely as a point of departure minimizes the importance of a rate of return figure. But if one is to be used in this matrix, we find it difficult to see why FPC would consider it important enough to adjust upward for new gas but not to any degree for flowing. The rate of return approved by the Supreme Court in *Permian* was 12%. The *SoLa II* return was 15%. While we tend to defer to administrative expertise to determine the appropriate rate there is much bewilderment with FPC's rate adherence to the 10.5% figure in *OSWA*.

Mobil expresses dismay with FPC's failure to provide some additional exploration and development component to flowing gas rates. In *SoLa II* we held that FPC *may* decide that gas committed under old contracts should bear its fair share of the burden for development of new resources to meet total demand. We did not hold there that it had to do so. Nor do we now. Yet it does seem

administratively incongruous to allow major interstate producers to recoup exploration and development expenses from gas which they sell under old contracts if it is produced in SoLa, but not if it is produced in OSWA, especially that portion which is in North Louisiana. Certainly that is so in the absence of explanation and the fact that Op: 607 was handed down on October 29, 1971, several months *after SoLa II* and Texas Gulf Coast decisions. See note 6, *supra*.

The producers also complain of FPC's use of the Btu allocation method [26] of assigning costs between jointly produced oil and gas. Making this allocation has been a problem for some time. In *SoLa I* FPC used the Btu method and determined that a ratio of 3.5:1 oil to gas would be appropriate in apportioning expenses. Then in

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[26] Exxon has filed a helpful supplemental memorandum detailing the Btu methodology. The problem is essentially this. Many dry holes are drilled in the course of the search for oil and gas. We are informed that 10,800 such holes were drilled in 1970 at a cost of approximately $873,000,000. Insofar as gas and oil are produced conjunctively, and the search is made for both, these expenses call for some allocation against the revenues of each. Likewise, exploration and development expenses for successful efforts must be apportioned.

Eschewing volumetric comparison FPC has in the past allocated these costs based upon the relative production of energy, measured in Btu's, of each fuel. See *SoLa I*, 428 F.2d 407, 422 n.30. The thermodynamic breakdown yields a ratio of 4:1, but a further adjustment to account for the industry's geographical and technological ability to drill directionally solely for gas reduces the ratio to 3.5.

To illustrate, if 10 Btu's of liquids and 10 Btu's of gas are produced in the test year and if $100 was expended in unsuccessful E&D, the calculation would be as follows:

(a) 10 Btu (Liquids) x 3.5=35
10 Btu (Gas) x 1.0=10

(b) Ratio of 35 to 45=0.78
Ratio of 10 to 45=0.22

(c) 0.78 x $100=$78 (Allocated to Liquids)
0.22 x $100=$22 (Allocated to Gas)

SoLa II it determined to abandon this method in favor of a direct assignment of expenses based upon producer-furnished data. But to tally the proceedings and court sanctions on one side or the other is fruitless.

We may assume that either method may be a permissible method of allocating the expenses, but in view of the Shell Protestants' factual allegation that use of the direct assignment method would have made a 6.17¢/Mcf difference in the flowing gas rate for OSWA, we cannot lightly cast the point aside. This is especially true since FPC, on Staff's recommendation, did abandon the Btu method in *SoLa II* in favor of direct assignments. Op: 598, ¶ 153. And in so doing it recognized the inherent judgmental factor in the Btu allocation.[27]

On reading this segment of Op: 607 one might well conclude that it hailed from the pre-*SoLa I* era. But Op: 607 was issued in the wake of *SoLa II*. See note 6, *supra*. FPC's failure to take account of this very serious factual allegation remains unexplained.

Of course a significant fact which permeates the flowing gas structure is that FPC acted upon a 1962 cost basis in establishing these rates. Since then a lot of water has gone under the bridge and a lot of gas through the pipes. But what are we to do?

In *SoLa I*, 444 F.2d 125, 126-27 (on rehearing) we observed:

> Under section 19(b) of the Natural Gas Act, this Court has the broad remedial powers that inhere in a court of equity, and pursuant to our equitable powers we make it part of the remedy in this case

[27] Our discussion of FPC's use of the Btu method of allocating exploration and development expenses between jointly produced oil and gas in no way pertains to the Shell Protestants' challenge to the so-called Btu "gap" in quality adjustments. See Shell initial brief at pp. 60-63. That argument has not been neglected—only rejected.

> that the authority of the Commission to reopen any part of its orders, including those affecting revenues from gas already delivered, is left intact. The Commission can make retrospective as well as prospective adjustments in this case if it finds that it is in the public interest to do so.

Again we find it desirable to employ these flexible powers of equity to enable FPC to deal effectively with the public interest as it may see the need. Therefore, although we attach the label "enforced" to the end of this opinion, we emphasize that under our decree FPC has the authority—just as it did after *SoLa I*—and subsequently reaffirmed by us in *SoLaII*—to alter or modify the maximum rates prospectively or retroactively which it established in Op: 607 for flowing, pre-October 1, 1968, gas if it believes that such a change would be in the public interest.[28]

Refunds

In *SoLa II* we approved FPC's implementation of an incentive program which permitted producers owing refund obligations to discharge them—not in cash—but rather at the rate of 1¢/Mcf through the commitment of new reserves to the interstate market. Initially FPC declined to allow this refund credit for OSWA claiming that the "refunds here ordered are of such small amount that a refund credit would not provide an incentive to any materially increased exploration and development program." Op: 607, ¶ 47. But on rehearing it recanted. "While the estimated amount of $5,000,000 (the Major Producers' estimate) is small by comparison with total

[28] Naturally since refund orders are obtained derivatively from the flowing gas rates this flexibility also extends to allow FPC to alter the total refund obligations accordingly if it chooses to modify flowing gas rates.

The same flexibility applies to any changes which FPC might want to make regarding the moratoria provisions.

dollar revenues of the industry in this area, and although the resulting stimulus may not be great, in this time of increasing gas supply stringency every incentive should be applied which may help to alleviate the situation." [29] Op: 607A, ¶ 4.

Mobil attacks the refund credit system as being unduly discriminatory and preferential. Its basic premise seems to be that FPC adopted this incentive in lieu of a higher rate which might have been obtained if the refund credit had not been put into effect. This is without merit.

As to the charge that the refund credit program discriminates, we enforce it on the basis of our lengthy discussion of the matter in *SoLa II*.

We refuse to fault FPC for coping with the gas shortage in every possible way. The refund credit program is fully sustained.

Moratoria

FPC has imposed a moratorium until July 1, 1973 on increased rate filings under § 4 of the Act which are above the area rates prescribed by Op: 607. It is vigorously attacked by all producers in this proceeding.

Moratoria are not new to area rate cases. They were sustained by the Supreme Court in *Permian* and by us

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[29] The New York Public Service Commission also points out that the refund credit program may be somewhat of a disincentive since producers who desire to elect the benefits under the new Optional Procedure for Certificating New Sales promulgated by Order 455, (see *SoLa II*; Part VII), must discharge all due refunds in cash. Thus, the incentives cancel out.

We think this is a matter within the judgment of FPC. The refund discharge program of OSWA is not to be discarded merely because it affords the producers an opportunity to choose which of two incentive plans, one perhaps more attractive than the other, will be selected.

in both *SoLa I* and *SoLa II*. Several factors prompted this action. Foremost among the justifications was the fact that some stability and rate certainty is needed if the industry is to be effectively regulated at all. Also, we cited and approved various alternative methods by which producers who are uniquely aggrieved by area rate ceilings may seek special, individualized relief. If that were all, we could merely enforce these moratoria provisions without further comment. But because our sanction in *SoLa II* was predicated in large measure upon factors not present here, we believe that some further comment is necessary.

In *SoLa II*, we said:

> There are also other substantial reasons for rejecting the producers' attack on the moratoria provisions. The marrow of their argument is that due to inflation and other economic factors, costs are very likely to rise substantially during the term of the moratorium. But two safeguards convince us that, if and when that contingency occurs, FPC is ready, willing, and able to make appropriate adjustments. First, the costing on 1969 data was relatively current and to a significant degree, the incentives established by Op: 598 apart from the rates themselves serve to bolster the financial position of the producers and protect them against rising costs. These are, of course, the provisions providing for the retention of large amounts of capital through the refund discharge program and the periodic and contingent escalations. Second, there are several alternative methods by which a single aggrieved producer may establish higher rates as his circumstances warrant.

—— F.2d at ——.

Not all of these factors are present here. While the new gas rates for OSWA are in parity with those adopted in *SoLa II*, the flowing gas ceilings here were not

adopted on the basis of 1969 data, but rather on the basis of a stale 1962 record. Likewise, the amount of capital which will be retained via the refund credit program is substantially less significant in OSWA, and there are no contingent escalation provisions. Therefore, piecemeal relief on a company-by-company basis may not be effective with respect to the industry's need for higher rates on flowing gas.

So, in keeping with the flexible approach which we are adopting with respect to flowing gas rates, we do not frame our decree for all time. Rather we hold that FPC may, in light of its evaluation of the gravity of our national energy crisis and the evidence concerning flowing gas rates for OSWA, modify or rescind the moratorium if the need arises.[30]

ENFORCED.

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[30] See note 28 and related text, *supra*.

APPENDIX C

Natural Gas Act, Sections 4, 5, and 19(b)

The Natural Gas Act, 52 Stat. 821 (1938), as amended, 15 U.S.C. § 717 *et seq*:

SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise order, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and

to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall

go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible. [52 Stat. 822 (1938); 76 Stat. 72 (1962); 15 U.S.C. § 717c]

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however*, That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of

such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas. [52 Stat. 823 (1938); 15 U.S.C. § 717d]

* * * *

SEC. 19. (b) Any party to a proceeding under this act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition such court shall have jurisdic-

tion, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in [former] sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, sec. 1254).

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